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OUTLOOK
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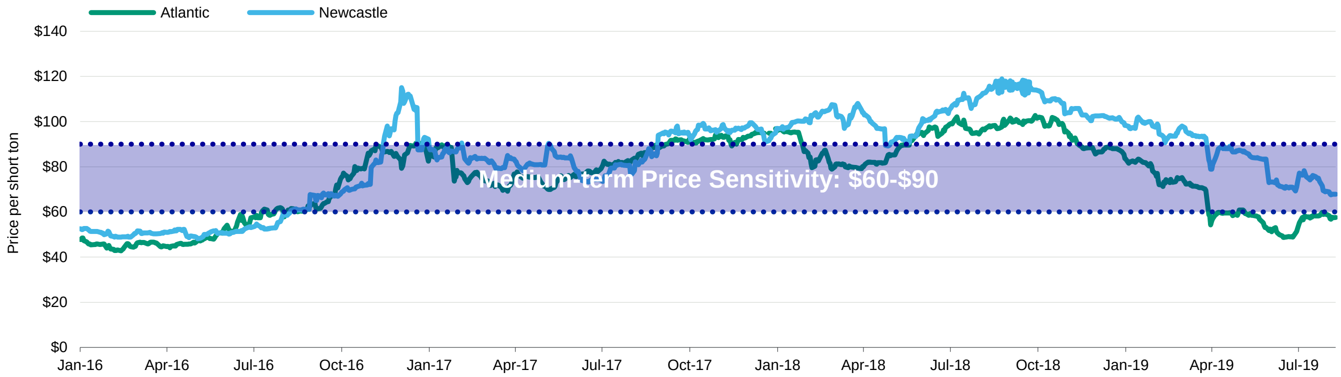
Coal – North America

Weak export prices tip outlook to negative

» **Profitability will worsen in the next 12-18 months.** Our negative outlook for the North American coal industry reflects our expectation for weaker EBITDA in the second half of 2019 and meaningfully weaker EBITDA in 2020. The EBITDA decline is expected to be more than 3% over the next 12 months, a trigger to change our outlook to negative. A substantive decrease in export prices for thermal coal, particularly in Europe, combined with mostly open contract positions for some producers in 2020, will drive this decline. Weakness in the steel industry will also result in lower earnings for metallurgical coal operations, though pricing remains favorable compared with historical levels. A confluence of economic, environmental, and social factors also increase our concerns about the industry's longer-term demand prospects, as pressure on the industry is mounting, which makes numerous coal mines uneconomic in a reduced demand environment, especially smaller, higher cost mines that are highly vulnerable to retirement of specific coal-fired power plants.

» **Our outlook for thermal coal is increasingly stressed as economic, environmental, and social factors weigh heavily on demand from utilities.** Our long-term outlook for US thermal coal calls for a substantial volume reduction over the next decade driven by utilities switching to natural gas and renewable energy, which still benefits from government subsidies today. However, stronger conditions in the export market over the past couple years helped prop up prices and allow many producers to generate meaningful cash flow to fund shareholder returns. We expect a combination of significant retirement of coal-fired power plants in 2018, combined with a now-weakened export market, will bring more tons back into the domestic market and could drive prices lower, especially if natural gas prices remain very low and coal producers attempt to maintain production near current levels. Rated producers are well contracted through 2019, but many have substantial open positions beyond that and only a few, such as Consol Energy (B1 stable), have contracted the vast majority of their volumes for 2020. Alliance (Ba3 stable), CONSOL, Foresight Energy (B3 stable), Murray Energy (Caa1 stable), and Wolverine Fuels (Caa1 stable) are heavily concentrated in domestic thermal coal. Some producers, such as Peabody Energy (Ba3 stable), are more diverse operationally, geographically, and across coal types.

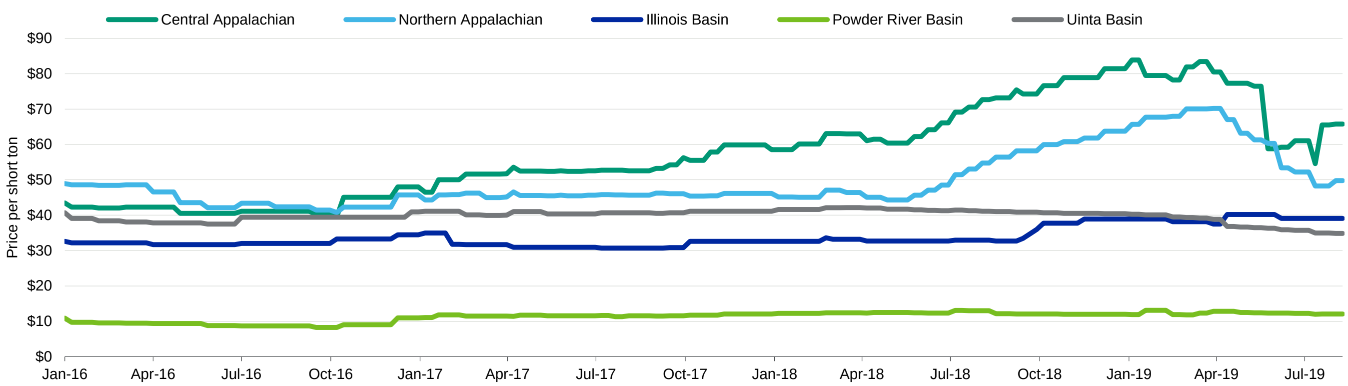
Exhibit 1
Thermal export prices drop significantly



Source: Factset. Our price ranges, as well as the midpoint, represent baseline prices we use to sensitize financial performance and evaluate risk when analyzing credit conditions of companies within the sector. We will periodically review, in light of changing global GDP and supply/demand expectations, these price sensitivities to better assess the resiliency of operating and financial performance of mining companies.

» **Our medium-term price sensitivity range for export coal are unchanged.** For Newcastle thermal coal we use a medium term price sensitivity range of $60-$90/metric tonne and $110-$170/metric ton for high-quality met coal. Our most recent revision to the sensitivity ranges in October 2018 incorporated the benefit from very limited investment in new mines over the past several years. While we expected price volatility for exports and believed thermal coal prices would moderate during the next couple years, the pace and magnitude of the decline for thermal coal in the Atlantic Basin exceeded our expectations. Relatively mild weather, continued emphasis on renewables, and import restrictions by China remain a downside risk for prices in the Pacific Basin. Over a longer horizon, as demand for thermal coal declines in the United States, we expect the industry will become more dependent on export thermal and met coal.

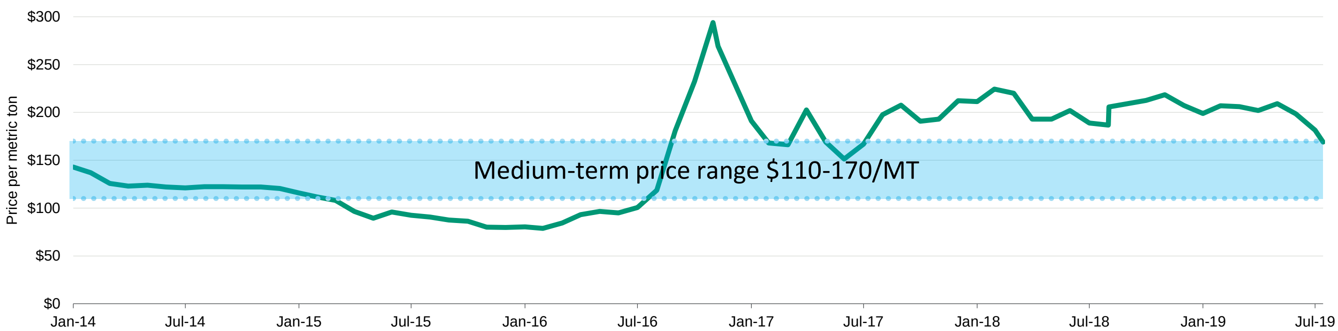
Exhibit 2
Domestic thermal prices declined over last several months



Source: EIA

» **Our outlook for met coal used in steelmaking is more favorable.** Some factors contributing to recent price weakness are temporary, but end-market demand from steelmakers is weakening and escalating trade tensions increase uncertainty heading into 2020. Our outlook for the European steel industry is negative and, while our outlook for the US steel industry is stable, steel producers' earnings will be down in 2019, with EAF producers faring better than those operating blast furnaces. Conditions for steelmakers in Asia are also weakening, particularly in China, where rising domestic supply of met coal and weakening demand by steelmakers are expected to pressure met coal pricing. Some met coal, like Contura Energy (B2 stable), are throttling back production a bit. Numerous miners announced acquisitions or potential expansions in met coal, including Arch Coal (Ba3 stable), Contura, CONSOL, Murray, Peabody, and Warrior Met Coal (B2 stable). Pricing remains at levels that will support reasonable earnings for producers, though somewhat lower than the figures for 2017 through early 2019. Over a longer horizon, we remain concerned that demand for metallurgical coal could tip into secular decline as the steel industry continues to shift toward electric arc furnaces, which recycle scrap steel, rather than basic oxygen furnaces, which make steel from pig iron from a blast furnace, which uses raw materials including metallurgical coal.

Exhibit 3
Metallurgical coal price dips to our medium-term price range
$/MT CFR Jingtang



Source: Metal Bulletin. Our price ranges, as well as the midpoint, represent baseline prices we use to sensitize financial performance and evaluate risk when analyzing credit conditions of companies within the sector. We will periodically review, in light of changing global GDP and supply/demand expectations, these price sensitivities to better assess the resiliency of operating and financial performance of mining companies.

Moody's related publications

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» FAQ on the economics of renewable energy, battery storage and fossil-fuel power plants, June 2019

Outlook

» Thermal coal remains in secular decline, but met prices support stable outlook, May 2019

» Outlook moves to negative on slowing end user demand, weaker steel spreads, May 2019

» Industry performance to remain solid on favorable fundamentals, economic factors, February 2019

» Steel-Asia 2019 outlook, November 2018

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